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September 7, 2006

Public Utility Commission of Oregon
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Re: UM 1234

Attention filing center:

Enclosed for filing please find the Staff Opening Brief in Docket No. UM 1234.

Thank you for your attention.

Very truly yours,

Stephanie S. Andrus
Assistant Attorney General

Enclosure
c. Service list

**BEFORE THE
PUBLIC UTILITY COMMISSION
OF
OREGON**

UM 1234

**In the Matter of
PORTLAND GENERAL ELECTRIC
COMPANY Application for Deferred
Accounting of Excess Power Costs
Due to Plant Outage**

STAFF OPENING BRIEF

SEPTEMBER 7, 2006

I. Introduction.

During and since the Western Power Crisis in 2001, the Commission issued several orders that elucidate and/or apply its policy regarding use of deferred accounting to recover power costs that vary from those implicit in rates.¹ The recommendation of the staff of the Public Utility Commission of Oregon (“staff”) to allow Portland General Electric Company (“PGE”) to defer costs associated with the forced outage of its Boardman Plant using a methodology that requires the company to share those costs with its customers, is consistent with these previous Commission decisions. The sharing mechanism that staff recommends is as follows:

1. Shareholders absorb 100 percent of the excess power costs in a deadband equivalent to 250 basis points of ROE;
2. Shareholders absorb 50 percent of the excess power costs in a sharing band between 250 and 400 basis points of ROE; and
3. Shareholders absorb 10 percent of the excess power costs beyond 400 basis points ROE.²

Staff’s recommendation is consistent with each of the Commission’s orders authorizing a power cost deferral since 2001, in which the Commission imposed this, or a very similar, sharing mechanism. It is also consistent with the Commission’s decision in Docket No. UM 1071 denying PGE’s request to defer excess power costs associated with poor hydro conditions that did not exceed an amount equal to 250 basis points of PGE’s ROE.

Although PGE argues in its testimony that the Commission should depart from the precedent and policy that requires sharing of extraordinary power costs that exceed power costs included in rates, PGE does not offer any persuasive reasons as to why. In absence of any persuasive reasons as to why the Commission should depart from

¹ Order No. 01-231 (Docket No. UM 1008/1009); Order No. 01-307 (Docket No. 1007); Order No. 01-420 (Docket No. UM 995); Order No. 04-108 (Docket No. UM 1071); Order No. 05-870 (Docket No. UM 1198); and Order No. 05-1070 (Docket No. UM 1147).

² Staff/100, Owings-Galbraith/19.

precedent, the Commission should adopt staff's recommendation to allow PGE to defer costs associated with the Boardman outage, subject to a sharing mechanism like that previously imposed for PGE, PacifiCorp and Idaho Power Company ("Idaho Power") for other power cost deferrals.

The costs at issue in this deferral application are those PGE incurred to buy replacement power during an outage of its coal-fired generating plant in Boardman, Oregon ("the Boardman plant"). The outage began October 23, 2005. The plant remained off-line until June 28, 2006. However, the costs at issue in this docket are only those incurred after November 18, 2005, when PGE filed its application for deferral, and before February 5, 2006, which is when PGE "deems" that the outage at issue in this docket ended.³

In testimony, staff addressed three issues presented by PGE's application for deferral: 1) whether PGE properly calculated the amount eligible for deferral; 2) whether the application satisfies relevant criteria for deferral; and 3) whether the Commission should impose a sharing mechanism on any deferral. The primary disagreement in this docket centers on the third issue. Staff, the Citizens' Utility Board ("CUB") and PGE agree that circumstances presented in this docket satisfy the relevant criteria for deferral. Staff and PGE disagree on only one aspect of the calculation of the amount eligible for deferral. The Industrial Customers of Northwest Utilities' ("ICNU") estimate of the amount eligible for deferral is only slightly less than staff's and. CUB does not dispute PGE's calculation..⁴ ICNU disagrees that PGE has satisfied the criteria for deferral and asserts that the amount eligible for deferral is slightly less than that asserted by PGE. Staff, CUB and ICNU are unified on the third issue and agree that any deferral should be subject to a sharing mechanism. All three of these parties recommend a sharing

³ PGE/100, Lesh/1.

⁴ CUB does raise concerns with PGE's decision to calculate the costs eligible for deferral by quantifying the cost of replacement power and avoided costs, as opposed to a quantifying PGE's net power cost variation. However, CUB does not take issue with PGE's estimate of the dollars eligible for deferral. CUB/100, Jenks/5-7.

mechanism that includes a deadband of 250 basis points of ROE and sharing between the company and customers of costs that exceed this level. PGE asserts that no sharing mechanism is appropriate.

In the following argument, staff addresses each of these issues.

II. Argument.

A. The amount eligible for deferral is \$42.8 million.

In its application and opening testimony, PGE asked the Commission to authorize it to defer \$45.3 million of excess net power costs. This amount includes the costs that PGE states that it incurred to between November 18, 2005 and February 5, 2006, to replace generation lost during the Boardman outage. Staff identified flaws in PGE's method of calculating excess power costs as well as minor errors in PGE's calculations.⁵ When staff's corrections to PGE's methodology and calculations are made, the amount eligible for deferral is \$42.8 million.⁶

PGE has accepted staff's modifications to its calculation of the excess net power costs eligible for deferral, with one exception.⁷ In calculating the replacement power costs, staff subtracted the normal power replacement costs PGE already recovers in rates. These costs are included in PGE's rates via the forced outage rate for the Boardman plant that is used in the calculation of PGE's power costs. The forced outage rate for the Boardman plant is 6.5 percent. Accordingly, staff calculated the replacement costs that are appropriately attributable to the outage by assuming that had the outage not occurred, the Boardman plant would have been available 93.5 percent of the time.

PGE asserts it is only appropriate to calculate the replacement power costs based on a Boardman availability of 93.5 percent if the company is also allowed to adjust its forecast of Boardman availability on a going-forward basis to achieve full cost recovery.

⁵ Staff/100, Owings-Galbraith/3-12.

⁶ Staff/100, Owings-Galbraith/12.

⁷ PGE/400, Lesh-Tinker/3-4.

PGE argues that staff's use of the 93.5 percent in the calculation of replacement costs is not appropriate because staff indicated that the traditional four-year rolling average calculation of "normal" plant availability should reflect Boardman as 100 percent available during the deferral period.⁸

Contrary to PGE's assertion, it is appropriate for the Commission to calculate the Boardman replacement costs assuming a 93.5 percent availability. PGE's current rates include allowances for plant forced outages. PGE already recovered normal replacement power costs associated with a forced outage rate of 6.5 percent at the Boardman plant during the October 23, 2005 through February 5, 2006 outage period. Calculating the Boardman replacement costs assuming 100 percent availability fails to account for this pre-determined recovery and results in a double-counting of replacement power costs.⁹

In other words, PGE's argument that the Commission must use the same availability for calculating the four-year rolling average on a going-forward basis and for calculating the replacement power costs for the Boardman outage fails to recognize that the pertinent consideration is not the percentage used in any future rolling outage rate, but the percentage used in the rolling outage rate in effect at the time of the outage. This percentage is 93.5, the same used by staff to calculate the costs eligible for deferral.

In any event, the relevance of PGE's complaint is questionable. Staff has recommended that the Commission abandon the four-year rolling average methodology for normalizing coal plant availability. In testimony filed in Docket No. UE 180, staff recommends that the Commission use North American Electric Reliability Council (NERC) peer group equivalent forced outage rates to normalize Boardman and Colstrip availability.¹⁰ The purpose of forced outage rate modeling is to normalize the power

⁸ Staff/100, Owings-Galbraith/21-22.

⁹ Staff/100, Owings-Galbraith/7.

¹⁰ UE 180/ UE 181/ UE 184, Staff/100, Galbraith/14.

costs included in a utility's base rates, not to provide recovery of replacement power costs associated with past forced outages.¹¹

Both PGE and staff agree that with the corrections identified by staff, including calculation of the replacement power costs assuming 93.5 percent availability of the Boardman plant, the excess net power costs that are eligible for deferral in this docket are \$42.8 million.¹²

B. PGE has satisfied the criteria for deferral.

When presented with an application for deferral under ORS 757.259, the Commission engages in a two-step decision process. One stage entails exercise of Commission discretion and the other requires the Commission to determine whether the proposed deferral is authorized by law. In this case, the Commission must determine whether the deferral will either match appropriately the costs borne by and benefits received by ratepayers or minimize the frequency of rate changes or fluctuation of rate levels.¹³ It must also determine whether the circumstances, specifically the type of event and magnitude of its impact on PGE, warrant deferral.¹⁴

The circumstances underlying this deferral application satisfy both the legal and discretionary criteria. First, deferral would appropriately match costs that PGE incurred to provide power to customers with the benefits of that power. Second, the type of event and the magnitude of its impact are such that deferral is warranted.

The Commission explained its analysis for the discretionary stage of its deferred accounting analysis in Order No. 05-1070 as follows:

The Commission will look to whether the event was modeled in rates, and, if so, whether extenuating circumstances were involved that were not foreseeable during the rate case, or whether the event fell within a

¹¹ UE 180/ UE 181/ UE184, Staff/100, Galbraith/8.

¹² ICNU estimates that the replacement power costs eligible for deferral are \$42.6 million. (ICNU/100, Falkenberg/16.)

¹³ ORS 757.259(e).

¹⁴ See Order No. 04-108 at 8.

foreseen range of risk when rates were last set. If the event was not modeled, we will consider whether it was foreseeable as happening in the normal course of events, or likely to have been capable of forecast. The Commission will examine whether or not the “risks are reasonably predictable and quantifiable.”

* * * The type of event – modeled in rates or not, foreseeable or not – will affect the amount of harm that must be shown by the utility. If the event was modeled or foreseen, without extenuating circumstances, the magnitude of the harm must be substantial to warrant the Commission’s exercise of discretion in opening a deferred account. If the event was neither modeled nor foreseen, or if extenuating circumstances were not foreseen, then the magnitude of harm that would justify deferral would likely be lower.¹⁵

In Order No. 05-1070, the Commission notes that staff’s distinction between stochastic and scenario risk is illustrative of its policy regarding deferred accounting.

A type of event that occurs at an unknown frequency, one that that is not susceptible to predication and quantification, can be characterized as scenario or paradigm risk.¹⁶ Events that occur during the normal course of business at a frequency that is quantifiable can be characterized as stochastic risk. Under the Commission’s policy, an event that is properly characterized as a stochastic risk must have a substantial financial impact to warrant deferred accounting. An event that is properly characterized as a scenario risk may warrant deferral with less financial impact than that required for a stochastic risk.

The Boardman plant outage is properly classified as a stochastic risk. Forced outages occur in the normal course of business. Forced outages such as the Boardman outage are foreseeable. Their frequency is quantifiable.¹⁷

Using the Commission’s order in Docket No. UM 1071 as a guide, the financial impact of the Boardman outage is “substantial.” The Commission’s order in UM 1071 is one of the orders mentioned above in which the Commission elucidates its policy

¹⁵ Order No. 05-1070 at 7.

¹⁶ Staff/100, Owings-Galbraith/3.

¹⁷ Staff/100, Owing-Galbraith/13-16.

regarding power cost deferrals. In that order, the Commission declined to set a rigid criterion for what qualified as a “substantial impact” for purposes of determining whether a deferral is warranted, but noted that a positive example of an impact that is substantial is one that exceeds 250 basis points of ROE.¹⁸ In this case, the amount eligible for deferral is equal to approximately 255 basis points of PGE’s ROE.¹⁹

In its rebuttal testimony, PGE spends a great deal of time attempting to refute staff’s conclusion that the Boardman outage is properly classified as a stochastic risk. However, as PGE ultimately acknowledges, whether the outage is classified as a scenario or stochastic risk is of little relevance to staff’s recommendation that the deferral be allowed.²⁰ This is because the financial impact of the outage appears to be “substantial,” and thus would necessarily satisfy the requirement that the impact associated with scenario risk be “material.”

For the reasons discussed above, staff disagrees with ICNU’s contention that the costs at issue do not satisfy the legal and discretionary criteria for deferral. First, ICNU argues that the proposed deferral would not appropriately match benefits and costs and would not minimize rate fluctuations. ICNU’s argument that the deferral would not appropriately match benefits and costs is merely that the recovery of deferred amounts will actually occur at a later time than the outage.²¹ ICNU’s argument is not persuasive.

Although ICNU is correct that PGE’s recovery of deferred replacement power costs will not coincide with the Boardman outage, the recovery could be within several months of the outage. The Commission’s process for deferral applications is not conducive to allowing utilities to recover deferred costs while the event causing the deferral is ongoing. The Commission’s process includes two distinct stages, a deferral and amortization stage, both of which can last many months. Staff doubts that ICNU

¹⁸ Order No. 04-108 at 7.

¹⁹ Staff/100, Owings-Galbraith/17.

²⁰ PGE/400, Lesh-Tinker/15.

²¹ ICNU/100, Falkenberg/12.

would be interested in abbreviating these processes to allow utilities to recover deferred costs at the same time they are being deferred.

ICNU devotes considerably more energy to establishing that the deferral would not minimize rate fluctuations. However, it is not necessary for PGE to establish that the deferral minimizes the frequency of rate changes and appropriately matches costs and benefits. As already noted, ICNU's argument that the deferral will not match costs and benefits because recovery of the deferred costs is not contemporaneous with the Boardman outage is not persuasive. It is not necessary for the Commission to examine ICNU's argument that the deferral will not minimize rate fluctuations.

ICNU also argues that the circumstances underlying PGE's request for deferral do not satisfy the Commission's discretionary criteria for deferral because the financial impact "scarcely" exceeds what the Commission appears to have previously accepted as a benchmark for what constitutes a substantial impact, which is an impact equivalent to 250 basis points of ROE.²² Staff agrees that the financial impact of the outage is close to 250 basis points of PGE's ROE. However, using previous Commission orders as a guideline, staff believes that this financial impact is sufficient to warrant deferral.

C. The Commission should impose the sharing mechanism recommended by staff.

The Commission's policy underlying imposition of a sharing mechanism for power cost deferrals is articulated in one of the orders issued in Docket No. UM 995, which concerned PacifiCorp's request to defer excess net power costs associated with poor hydro conditions, unprecedented market prices and a forced plant outage. In that docket, the Commission accepted staff's proposal for a sharing mechanism, which is almost identical to that recommended by staff in this docket. Staff's proposed sharing

²² ICNU/100, Falkenberg/ 17.

mechanism in that docket was guided by four principles, three of which are pertinent here.²³ They are as follows:

- Utilities typically bear the risks and rewards of revenue and cost changes between rate cases and should be protected only to the extent that cost changes are truly extraordinary;
- Risks should not be completely shifted from the utility to its customers. It is appropriate to share even the risks of extraordinary cost changes;
- The utility should receive incentives to minimize costs.²⁴

In Docket No. UM 995, staff asserted that its proposed mechanism, with a deadband of +/- 250 basis points of ROE, would capture the normal business risk that the company is generally exposed to between rate cases by requiring PacifiCorp to absorb the costs it would ordinarily absorb before making a rate filing.²⁵ Staff also asserted that the sharing bands of the proposed mechanism “appropriately apportion[ed] to the company risks that the company would normally assume between rate cases, including weather risk and other risks that a company also assumes[,]” and that the proposed sharing levels provided PacifiCorp with incentives to minimize its power costs.²⁶ The Commission expressly adopted these assertions.²⁷

Staff’s proposed mechanism is consistent with the reasoning expressly adopted by the Commission in Docket No. UM 995. As explained in testimony, staff recommends that the Commission impose a deadband equal to 250 basis points of ROE because PGE’s shareholders typically bear the risk of generating plant outages and increased power costs. A 250 basis point deadband captures the normal business risk that the company is generally exposed to between rate cases.²⁸ The sharing bands allow the company to share

²³ The fourth principle concerned shielding PacifiCorp’s Oregon customers from load growth in other states, which is not pertinent to PGE.

²⁴ Order No. 01-420 at 4-5.

²⁵ Order No. 01-420 at 7.

²⁶ *Id.*

²⁷ Order No. 01-420 at 29.

²⁸ Staff/100, Owings-Galbraith/20.

extraordinary costs associated with the Boardman outage with its customers. The mechanism also provides an incentive to utilities to minimize power costs in the future.

PGE asserts that the Commission should not impose a sharing mechanism for the following reasons:

- There is no statutory requirement that a deferral include a sharing methodology;
- In this instance, an earnings test is the best means to ensure that any amount authorized for amortization is reasonable;
- Proper regulatory policy would treat all deferrals the same, and the Commission does not require sharing for all deferrals.²⁹

As a preliminary matter, staff notes that for the most part, PGE's arguments ignore the Commission's orders issued since 2001 regarding requests by PacifiCorp, PGE and Idaho Power to defer excess net variable power costs. PGE's arguments, itemized above, do not address why the Commission should now abandon the policies previously articulated in Docket No. UM 995 and followed in other power cost deferral dockets.³⁰ In absence of any meaningful discussion of why the policy underlying sharing mechanisms for power cost deferrals is unnecessary or inappropriate, PGE's testimony that the Commission should not impose a sharing mechanism in this docket is not persuasive.

In any event, PGE's arguments are of little merit. First, PGE's argument that the Commission should not impose a sharing mechanism because ORS 757.259 does not require one is not well-founded. In fact, ORS 757.259 does not *require* the Commission to authorize any deferrals, except in a few limited circumstances. The Commission has discretion to authorize utilities to defer actual costs when the Commission believes the circumstances warrant the deferral and the deferral otherwise satisfies statutory criteria.

²⁹ PGE/400, Lesh-Tinker/16-17.

³⁰ See also CUB/100, Jenks/8-9 (Discussing Commission's orders in Dockets No. UM 995, UM 1071, UM 1007, UM 1008/1009 and UE 165/UM 1187, which apply or refer to the 250 basis point deadband).

The Commission similarly has authority to limit the amount of the deferral when it believes the limitation is warranted by the circumstances.

PGE's argument that the Commission should not impose a sharing mechanism in this case because the Commission does not do so for every deferral is also not persuasive. This argument fails to undermine the policy reasons underlying the Commission's imposition of a sharing mechanism, which is to require the company to absorb costs it reasonably should be expected to absorb in the normal course of business, even when the sharing of extraordinary costs is warranted. To the extent that PGE argues the Commission's treatment of deferrals is suspect because the Commission does not uniformly impose a sharing requirement, the solution is not for the Commission to abandon its policy requiring a utility to maintain the normal level of risk, but to examine deferrals authorized in other circumstances to determine whether sharing is appropriate.

Finally, PGE's argument that the sharing mechanism is not necessary because other mechanisms, such as the earnings test, protect ratepayers from unwarranted costs is also without merit. An earnings test, which in essence ensures that the utility does not receive a windfall through the deferral, does not perform the same function as a deadband. The purpose of the deadband recommended by staff is "to capture the normal business risk that the company is generally exposed to between rate cases."³¹

Finally, to the extent PGE may argue that a sharing mechanism with a deadband of 250 basis points of ROE is not appropriate in this case because the Boardman outage is properly classified as a scenario risk, the argument is without merit. The deadband assigns the typical risk for changes in operating expenses between rate cases to PGE. That typical risk includes changes in costs associated with weather variability, load changes and plant outages. Whether the duration of the outage makes it a stochastic or

³¹ Staff/100, Owings-Galbraith/20.

scenario risk does not alter the fact that utilities bear some risk for forced outages. The deadband is designed to ensure that PGE absorbs the portion of costs associated with the Boardman outage that is equivalent to normal business variation in operating costs. Whether the Boardman outage is a stochastic or scenario risk does not change that fact that PGE should absorb the costs of the outage that it would typically bear between rate cases. Accordingly, whether the risk of plant outage is classified as scenario or stochastic should not change the Commission's conclusion that a sharing mechanism with a deadband is appropriate.

To the extent PGE may argue that utilities do not assume risk of plant outages that last as long as that at issue in this docket, the argument is also not persuasive. The sharing mechanism does not require the utility to assume all the risk of the extended outage, only the portion resulting in costs that are equal to or less than those PGE is generally expected to absorb between rate cases. PGE is allowed to share with customers the costs that exceed this amount.

Finally, PGE's argument that the deferral should not be subject to a sharing mechanism is inconsistent with the Commission's decision in Docket No. UM 1071. In that docket, PGE asked the Commission for authorization to defer \$31.6 million in excess net variable power costs associated with below normal hydro conditions. The Commission declined to do so, noting that \$31.6 million equaled 172 basis of its ROE, which is "well short of the 250 basis points of return on equity within which [the Commission] allowed no recovery in UM 995."³² Meaning, the Commission rejected PGE's application, at least in part, because the amount at issue was less than what PacifiCorp had been required to absorb in Docket No. UM 995.

³² Order No. 04-108 at 9.

D. The Commission could adjust the deadband to minimize the impact of SB 408.


In Order No. 06-400, the Commission noted that it would consider the effects of SB 408 when evaluating issues in other dockets, such as those concerning power cost adjustment mechanisms. PGE notes that there will be SB 408 effects if staff's deferral mechanism is implemented. Specifically, PGE's 2006 tax obligations will be less than anticipated because of the excess net variable power costs PGE incurred during the 2006 portion of the deferral period. PGE asserts that all else being equal, the excess costs would trigger a credit to customers, and a loss to PGE, of an additional 40% of the 2006 replacement cost PGE incurred.

If the Commission wishes to address this impact, it could adjust the deadband to account for the tax effect of the replacement costs, which is roughly 98 basis points ($250 \times 39.3\% = 98$). However, this adjustment to the deadband should only be made for recovery of replacement costs incurred during 2006, because there is no SB 408 effect for PGE's taxes paid in 2005 on the replacement costs.³³

DATED this 7th day of September 2006.

Respectfully submitted,

HARDY MYERS
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³³ PGE incurred \$21.549 million in deferral period excess power costs during 2006. This represents 47% of the total deferral period excess power costs. See Staff Response to PGE Data Request No. 1, UM 1234 Final SAS Output.doc, Galbraith Work Papers/88.

1 **CERTIFICATE OF SERVICE**

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3 I certify that on September 7, 2006, I served the foregoing upon all parties of record in
4 this proceeding by delivering a copy by electronic mail and by mailing a copy by postage prepaid
5 first class mail or by hand delivery/shuttle mail to the parties accepting paper service.

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